IT 08-0008-GIL 03/12/2008 INTEREST INCOME

General Information Letter: Explanation of Illinois income tax treatment of federally tax-exempt bond interest.

March 12, 2008

Dear:

This is in response to your letter dated January 10, 2008 in which you request answers to a survey on Illinois taxation of municipal bonds. The nature of your request and the information provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c), which may be accessed from the Department's web site at www.ILtax.com.

Your letter states as follows:

> We are currently reviewing your state's tax treatment of municipal bond income for the 2008 tax year. We collect this data annually for the benefit of COMPANY clients who are residents of your state. While we realize your state's tax laws could change during the course of the year, we intend to publish available data by March 1, 2008. Therefore, we would appreciate a response by February 15 with the best current available information for the 2008 tax year. If 2008 information is not yet available, please provide information on currently effective tax law. Please inform us of the following:
>
> 1) How does your state account for federal and state tax deductibility on federal and state income tax returns? (circle one)
>
> a) One-way deductible – The only deduction available to taxpayers is the deduction of state and local taxes paid from the federal income tax base.
>
> b) Cross-deductible – Taxpayers deduct state and local taxes paid from federal tax base and also deduct federal taxes paid from state income tax base.
>
> c) Cross-deductible with add-back – Same as cross-deductible, but also requires the taxpayer to add-back to his or her state income tax base all state and local taxes paid which were deducted from federal taxable income.
>
> d) Piggyback tax – Taxpayers deduct state and local taxes from federal taxable income as in the one-way deductible method. However, the state income tax is a percentage of the federal tax liability.
>
> e) Double-deductible – Taxpayers deduct state taxes paid from federal taxable income and also from the state income tax base.
>
> f) No state tax – At this time this state does not levy a state income tax.
>
> g) Other – Please explain the method your state uses to calculate an effective state tax rate.

REPLY: Illinois law does not allow a deduction for federal taxes, and requires an addition modification for Illinois income taxes deducted in computing federal adjusted gross income.

2) Does your state tax municipal bond income on out-of-state municipal bonds? Yes or No (circle one)

REPLY: Yes, these sums are added back to federal adjusted gross income in the computation of Illinois base income. 35 ILCS 5/203(a)(2)(A).

3) Does your state tax municipal bond income on in-state municipal bonds? Yes or No (circle one)

If the income from only certain municipal bonds is exempt from state taxation, please include the section of your state tax code that lists those bonds which are state tax exempt.

REPLY: The Illinois Income Tax Act (IITA) provides a subtraction from adjusted gross income in the computation of Illinois base income for items of income that are exempt from taxation under either Illinois law or federal law. In the case of income exempt under Illinois law, the subtraction is net of any amortized bond premium. 35 ILCS 5/203(a)(2)(N). Under this provision, interest income from certain in-state municipal bonds is not taxed. See 86 Ill. Adm. Code 100.2470(f) for the list of exempt obligations.

4) Are intangible taxes levied in your state on in-state municipal bonds? Yes or No (circle one) If yes, is there an exempted amount? Are intangible taxes levied in your state on out-of-state municipal bonds? Yes or No (circle one) If yes, is there an exempted amount? If so, please send us all pertinent information relating to intangible taxes in your state.

REPLY: Article IX, Section 5 of the Illinois Constitution forbids ad valorem personal property taxes. Accordingly, Illinois does not impose intangible taxes on either Illinois or out-of-state municipal bonds.

5) Please complete or attach the current rate(s) of taxation and include the graduated income levels if applicable, for the 2008 year.

REPLY: Article IX, Section 3 of the Illinois Constitution forbids a graduated income tax. Individuals are taxed at the rate of 3%. C corporations are taxed at 4.8%.Certain entities pay an additional Personal Property Tax Replacement Income Tax at the following rates: C corporations, 2.5%; S corporations, 1.5%, Trusts, 1.5%, and Partnerships, 1.5%.

6) Were there any changes to your state's tax code in 2007 or are changes pending for 2008 that would affect holders of municipal bonds.

REPLY: None at this time.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)